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General Business Conditions

THE past month has witnessed a swift retreat by the American people from the philosophy of price controls, and rapid progress towards restoration of free markets. Following many months of debate over the price control issue, during which sentiment has been widely divided as to what controls could be safely abandoned and when, the disintegration of the wartime system of government price regulation has come with dramatic suddenness. In a rising tide of popular revolt over black markets and control-aggravated scarcities, price limitations on most foods have been swept away, and the Government has announced its intention of speeding the lifting of other controls wherever possible under existing legal standards and "to an extent compatible with our national security." While it remains to be seen with what despatch the Government will act upon these expressed intentions, the general conviction is that the people have had enough of government price regulation, and that the national economy is, with a few possible exceptions, turning rapidly back to reliance upon supply and demand as the governor of prices rather than the decisions of official price administrators and control boards.

The explanation of this sudden mass uprising against controls goes back to what happened at the time of the temporary expiration of OPA on June 30 last. Then and during the period since, the people of this country have had a forceful demonstration of the workings of economic law in an area — food — where the lessons have been driven home to everyone, rich and poor alike. People everywhere saw that while ceiling prices were still on meat before the OPA "holiday", actually very little meat came out at these prices and most of what got into consumption went around through the black market. They saw that when ceilings went off with the temporary lapse of OPA on June 30 prices went up, to be sure, but quickly leveled off, and in many cases reacted, under pressure of increased supplies — and it was possible to get meat. Then they saw prices put back under ceilings, with re-establishment of OPA, and once more meat disappeared from the markets.

With this practical test of controlled versus free markets, the American people suddenly decided that it was better to pay higher prices and be able to get meat than it was to have lower prices and go without. The result was to evoke such a storm of public protest as not only to cause scrapping of meat controls but to shake the entire control system to its foundations.

Charges Against "The Interests"

Despite the obvious spontaneity of the uprising against controls, there has been the usual outcropping of charges of plots and conspiracies being put over on the public by small but powerful behind-the-scenes groups generally identified vaguely as "monopolists", "the interests", "the trusts", and "Wall Street", etc. According to Walter P. Reuther, president of the United Automobile Workers (CIO): "Now, for the second time in a year, will a miracle be wrought. Cows, which today do not exist, to-morrow will be born, reared, fattened, marketed, and in 24 hours will be on the shelves of your butcher shop. This miracle will come about because the great meat trust has forced organized shortages into a political club."

Such statements are unfortunate at a time when there is need for the widest possible understanding of the forces at work in the economy. The truth is that the bursting of the bonds of controls has come in a field that could hardly be less susceptible to plots and "organized shortages" by the "meat trust" or any other group.

The markets for livestock and meats are influenced by hundreds of thousands of producers on the farms and ranches, big and little, all making independent decisions as to whether to sell or not sell. It was, in fact, these very widespread ramifications of the meat industry, and difficulty of organized control, that led to the breakdown of OPA regulations. As Presi-

dent Truman pointed out in his radio address to the nation on October 14, Government seizure of the packing houses would have afforded no solution "because the seizing of empty packing plants would avail us nothing without the livestock," and seizing the cattle on the farms and ranges "would indeed be a drastic remedy," and "wholly impracticable because the cattle are spread throughout all parts of the country."

What has been happening, in short, is not the result of a plot or the selfish greed of a few. It is simply a return to a system of economic law again finding expression in a free market. There are some people who do not like this system, but prefer a system of state controls backed up by force. Free markets are bound to have fluctuations, and people are going to get hurt if they make wrong decisions. But this is the essence of democracy, after all — where people themselves make decisions and take the consequences. The great majority of Americans want no other system.

Production the Key

All this has demonstrated the urgent necessity of getting goods people can buy into the markets and in quantities sufficient to satisfy the demands. This requires two things —(1) a careful examination by the Government of remaining price controls with a view to modifying or removing any that are acting as a brake upon output; and (2) avoidance of repetition of the disastrous industrial disputes which have held back production and accentuated scarcities in so many lines over the past year.

As to (1), while the President in his radio address emphasized the remarkable recovery that has taken place in production generally, despite all handicaps, and indicated that "as shortages continue to disappear, the inflationary pressures will ease and the need for government controls will pass," he at the same time called for continuance of controls on rents and "certain basic materials and other commodities of which there is now a grave shortage . . . until production of them has been greatly increased." The question to be weighed, of course, is whether the continuance of controls may not so retard the expansion of production as to prolong the period of shortages and thus possibly accentuate the inflationary pressures in the end.

On the matter of industrial disputes, it is evident that neither management nor labor can afford a continuance of the strife that has marred the reconversion thus far. Both parties have a heavy responsibility for trying to work out amicable arrangements that will permit production to go forward and goods and services to be offered at prices that people can pay. A new round of major strikes such as afflicted the country early this year would be a grievous setback in the battle against inflation. On the other hand, an avoidance of strikes on the basis of settlements that would greatly increase costs and prices could have an equally calamitous effect in fostering a boom-bust pattern.

A Test of Economic Understanding

The situation poses a test of the people's comprehension of the nature and obligations of economic relationships, and ability to recognize danger signals when they are flying. It imposes upon business the obligation of avoiding an inventory buying spree and of having the wisdom to realize that a policy of moderate pricing and large volume may pay more in the end than one of charging all the traffic will bear, and thus not only contributing directly to inflation but inviting the charge of profiteering and retaliatory wage demands on the part of the workers. It imposes upon labor the obligation to recognize that excessive wage demands lead only to higher costs, price increases that rob wages of their purchasing power, instability, and ultimately loss of jobs. It imposes upon people generally the obligation to keep their heads and not go rushing out after scarce merchandise and driving up prices, when the exercise of a little patience would soon see goods enough for all.

So far as management is concerned, the attitude in most quarters is one of increasing caution in the face of the problems that now seem to be looming ahead. The stock market decline, the steadily rising costs of doing business, and indications in many lines that the shift from sellers' to buyers' markets has already come or is not far distant, have brought a note of sobriety into most business discussions. Extravagant programs of buying and expansion are being brought down to earth, and far-sighted business men are preparing themselves for a period when selling is expected to be a much more competitive job than it has been in the recent past. This tempering down of business expectations is wholesome in tending to take some of the fever out of inflation, thereby lessening the chances of a more serious setback later on.

The chief cause for uncertainty now lies in the threatened new wave of wage demands, with the prospect of strikes to enforce them if not granted. Coming at a time when it has been hoped that bountiful harvests and increasing industrial output might soon get the better of inflation and lead to lower prices, this is disheartening. While labor spokesmen seek to justify the new wage demands on grounds of the further rise in the cost of living, the experience of the past year has amply demonstrated that raising money wages affords no permanent solution, but merely carries the wage-price spiral another turn higher.

The real remedy lies in production and in increasing the quantity of goods in the market. The great question is whether labor will see its advantage in concentrating upon this goal, or whether it intends to use its great power to try to drive up wages by main force regardless of consequences. The answer to this question may well determine whether the country can go forward to full production and high employment without serious interruption.

Third Quarter Corporate Earnings

Benefitted by unprecedented peacetime sales volumes in many lines, higher prices, and the lull in industrial disputes, net earnings of corporations reached the highest level of the year during the third quarter. For a group of 350 industrial corporations which report quarterly, aggregate net income after taxes for the third quarter was around 70 per cent above the third quarter of 1945 when the excess profits tax was in effect and net income was depressed by cancellations of war orders and reconversion costs. As a result of this relative improvement, a decline in earnings in the first six months comparison was converted into an increase for the first nine months of 12 per cent. The importance of the removal of the excess profits tax is indicated by the fact that earnings before taxes were in most cases lower than in the first nine months of 1945.

In contrast to industrial profits, preliminary figures for railways, despite traffic volumes which break all previous peacetime records, indicate net income for the nine months only a sixth that of the same period of 1945.

Individual corporations show a great diversity of profits experience. The biggest gains generally came to companies which could supply goods in large volumes to meet urgent demands of a market which had been starved of many classes of commodities during the war, which has been enjoying unprecedentedly large current incomes, and which had large accumulated savings. For companies which normally have considerable amounts of working capital tied up in inventories, profits tended to be distorted by the rising price level.

For numerous companies the reported net income was increased, or the net deficit reduced, by the application of carryback tax credits or the use of postwar reserves, which are non-recurring and tend to conceal the unsatisfactory results of the current operations. The real test of earnings will come when the gap of deferred demands begins to be filled and when these credits and reserves are no longer available. The decline in stock prices since last summer has indicated real investor skepticism on this score.

Producers of consumers' nondurable goods (most of whom were little hampered by reconversion difficulties and strikes) together with retail merchants and service establishments, have been the chief beneficiaries of the immediate postwar demands — retailers, motion pictures, and manufacturers of textiles, paper, foods, chemicals and drugs, and liquor. Gains in this class for the nine months in some cases ran to 50 per cent or more. Figures are not available for the large meat packing companies whose operations were curtailed during most of the period by reduced marketings of livestock through legitimate channels. As the fourth quarter began some of the companies in the broad field of consumers' nondurable goods and retail trade were beginning to sense a gradual filling up of the most urgent demands, a greater discrimination on the part of consumers, and the start of an inevitable shift from the abnormal sellers' market conditions.

Spotty Results in Durable Goods

For producers of durable goods, demands are very far from being filled, because of interruptions to production resulting from numerous and prolonged labor disputes, shortages of materials, time required for reconversion, and the very magnitude of demands in relationship to production facilities. For a number of companies in the durable goods line the task in the third quarter was to offset deficits caused by strikes in the first half. The steel companies, by operating close to capacity, were able to bring their profits for the nine months well ahead of 1945. For electrical equipment and automobile manufacturers, which were able to come out a little better than even for the nine months, profits were a small fraction those of 1945. Producers of building supplies and equipment had a spotty profits experience depending on amounts of materials they were able to procure and effects of labor disputes. The experience of machinery manufacturers was likewise mixed while aircraft manufacturers showed drastic declines.

Our tabulation of 350 industrial companies for the first nine months shows total net income after taxes of approximately $1,100 million, compared with $982 million in the same period of 1945, an increase of 12 per cent. Net worth of the group, comprising mainly the larger manufacturing organizations of the country, aggregated $14.8 billion at the beginning of the year, upon which the nine months' earnings were at an annual rate of 9.9 per cent, compared with a net worth of $14.4 billion in 1945 and a return of 9.1 per cent. Both percentages are below the levels for years of prosperous business and plentiful employment opportunities before the war.

The accompanying summary gives comparative figures for certain major industries, based upon reports available at this time.

NET INCOME OF LEADING CORPORATIONS FOR THE FIRST NINE MONTHS

Net Income is Shown as Reported — after Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends. Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Net Income Nine Months 1945	Net Income Nine Months 1946	Per Cent Change†	Net Worth January 1 1945	Net Worth January 1 1946	Annual Rate of Return % 1945	Annual Rate of Return % 1946
27	Food products	$ 58,655	$ 84,382	+43.9	$ 714,474	$ 722,231	10.9	15.6
16	Pulp and paper products	18,898	44,242	+	396,087	415,487	6.4	14.2
35	Chemicals, drugs, etc.	135,028	201,516	+49.2	1,683,655	1,748,206	10.7	15.4
16	Petroleum products	182,345	190,340	+ 4.4	2,406,532	2,511,674	10.1	10.1
16	Cement, glass and stone	26,474	40,303	+52.2	445,072	480,160	7.9	11.2
30	Iron and steel	122,338	174,580	+42.7	3,477,697	3,521,682	4.7	6.6
13	Electrical equipment	66.332	19,953	—69.9	797,587	862,474	11.1	3.1
23	Machinery	20,589	23,126	+12.3	300,419	304,956	9.1	10.1
21	Autos and equipment	165,450	22,360	—86.5	1,509,735	1,573,360	14.6	1.9
52	Other metal products	65,142	75,468	+15.9	921,518	971.598	9.4	10.4
42	Miscellaneous mfg.	47,677	107,603	+	597,066	628,837	10.6	22.8
291	Total manufacturing	908,928	983,873	+ 8.2	13,249,842	13,740,665	9.1	9.5
27	Mining and quarrying	44,224*	50,320*	+13.8	690,355	606,579	8.5	11.1
21	Trade (whol. and retail)	21,181	54,340	+	300,097	422,315	9.4	22.5
11	Service	7,959	11,619	+46.0	139,848	140,921	7.6	11.0
350	Total	$982,292	$1,100,152	+12.0	$14,380,142	$14,810,480	9.1	9.9

*Before depletion charges in some cases. †Increases or decreases of over 100% not computed.

Effect of Federal Taxes

Income tax details, given by a majority but not all of the companies reporting for the nine months, show that net earnings before taxes were about 10 per cent below last year, while reserves for federal income taxes this year were 46 per cent below the combined reserves last year for both income and excess profits taxes. Whereas such taxes, on the average, absorbed 59 per cent of net earnings last year, the average this year declined to 35 per cent.

These tax comparisons exclude 15 companies (among which were such organizations as General Motors, General Electric, Westinghouse Electric, and United Aircraft) reporting no tax liability this year but a net tax credit instead, due to a serious drop in earnings or a net deficit. This group reported a combined net income this year of approximately $24 million, against $221 million net income in 1945; had it not been for net tax credits of $181 million, plus the use of $39 million in reserves, the 1946 operations would have shown instead a deficit of $196 million. Such tax adjustments based upon a carryback of unused excess profits tax credits will no longer be available after December 31, 1946, although an operating deficit in 1947 can under the revenue law be the basis for an application for refund of income taxes (but not excess profits taxes) paid in 1945, up to 40 per cent of the 1947 deficit.

Of 120 manufacturing companies reporting sales figures, the number having sales decreases for the first nine months exceeded the number with increases by three to two, whereas the combined total (reflecting the sharp decreases by large steel, automobile, electrical equipment and aircraft companies) was down 38 per cent. In contrast, the sales of leading retail companies for the nine months were up 33 per cent.

Because of the abnormal changes in industry and trade as a result of such factors as the ending of the war, the widespread strikes, the reconversion of plants and equipment to peacetime production, and the rising trend of costs and prices, the sampling represented by the comparatively small number of companies publishing interim reports is of limited significance, either for accurate measurement of current earnings or for indication of postwar earnings. In addition to being affected by accounting adjustments, the interim statements are subject to further adjustment of tax and other reserves after the close of the fiscal year.

The International Bank and Fund

Late in September, following upon inaugural meetings held in Savannah last March, the governing boards of the International Bank for Reconstruction and Development and the International Monetary Fund gathered in Washington for their first annual meetings. Tentatively approved by technical representatives of 44 nations at Bretton Woods in July, 1944, and made effective by 30 signatures on December 27, 1945, the two financial institutions are now taking their places among the growing number of organizations dedicated to international cooperation.

Present for the meetings were the Bank and Fund Governors representing each of the 39 member countries, their advisers, observers from certain other countries and other international agencies, Executive Directors and Alternate Executive Directors of the two new institutions, and officers and members of the staffs that have been assembled. Of the 51 countries which are members of the United Nations, Russia and 12 others are absent from the rolls of the Bank and Fund. Four countries — Italy, Turkey, Syria and Lebanon —

were approved for membership in the recent meeting, and the French quotas in the Fund and Bank were increased $75,000,000 each to $525,000,000.

Particularly because of the nonparticipation of Russia, the proportion of the total resources of the two organizations represented by the United States contribution has been automatically raised — from 31 to 36 per cent for the Fund and from 35 to 40 per cent for the Bank. In terms of money that is readily acceptable today in any part of the world, however, the American contributions are a much higher percentage, more like 70 or 80. It is a big stake — involving commitments running to $5,925,000,000 — that we have in the success of these new institutions.

Some Ambiguities Clarified

The controversies provoked both here and abroad by the Bretton Woods proposals and ambiguities in the basic statutes are brought back to mind by requests for interpretations of the statutes by the United States and British Governments, as well as by abstention from membership by some countries, such as Australia and New Zealand, where fear has been expressed that the Fund would interfere with domestic policies or force them back to a gold standard.

The request by the British Government for an interpretation of Article IV, Section 5, of the Fund (on the right of a member to change its currency parity) is founded on the latter sort of apprehension. In essence the British asked whether they could devalue their currency without objection from the Fund if they considered it necessary in order to maintain full employment at a time when their balance of payments was under pressure. The Executive Directors of the Fund ruled, in effect, that there could be no objection to devaluation to combat chronic or persistent unemployment arising from pressure on the balance of payments, providing the action was necessary to correct a "fundamental disequilibrium"; but asserted the right of the Fund to determine whether the action proposed was indeed necessary to correct a fundamental disequilibrium.

Since so much depends on interpretation, this ruling still leaves unanswered the question as to how much solid meaning there is in the statutes of the Fund calling for the maintenance of stable currencies. Only time can answer this question.

An American request, pursuant to a provision by Congress in the enabling legislation recommended by the American Bankers Association, was for an interpretation as to whether the authority of the Fund to use its resources extends beyond providing *temporary* assistance in connection with balance of payments fluctuations, or whether, on the contrary, the Fund can be used to finance relief, reconstruction, armaments, or large or sustained outflows of capital. The Directors ruled that the use was limited and not for the broader purposes. This is a welcome decision that somewhat allays fears that the Fund as set up invites misuse of its resources.

A closely related American request for interpretation was whether the Bank could make long term currency stabilization loans. The Executive Directors of the Bank ruled that, at least in "special circumstances," this was permissible. Here the problem was one of seeing that the doors of the Bank are open to an important type of credit need which, if not met by the Bank, will increase the danger that the Fund's resources will get tied up for long periods of years. The extension of long-term credits is not a proper function of the Fund.

International Bank to Start First

The Bank fixed June 25 as the date for formally starting its operations. This did not mean the commencement of lending operations, but was a necessary preliminary, required by its statutes, to getting in capital subscriptions. A series of calls for funds is designed to bring in, by May 26, 1947, the equivalent of nearly $1,600,000,000 (20 per cent of subscribed capital) of which more than $700,000,000 will be in gold or United States dollars and the rest in other currencies.

The accompanying table shows how the Bank's resources will stand when these payments are in. The figures are based on the present capital subscriptions and membership.

Projected Resources of the International Bank, May 26, 1947
(Expressed in dollars or dollar equivalents)

Paid in Capital:	Gold and U. S. Dollars	
	subscribed by the United States	635,000,000
	subscribed by other countries	90,927,000*
		725,927,000
Paid in Capital:	Other Currencies — convertible (after the Bank's subscribed capital has been entirely called) into gold, U. S. dollars or a currency required to discharge obligations of the Bank	
	British pounds	234,000,000
	Chinese yuan	108,000,000
	French francs	94,500,000
	Indian rupees	72,000,000
	Canadian dollars	58,500,000
	Netherlands guilders	49,500,000
	Belgian francs	40,500,000
	34 other currencies	207,828,000
		864,828,000
Subject to Call†:	Gold or U. S. Dollars—or a currency required to discharge obligations of the Bank	
	subscribed by the United States	2,540,000,000
	subscribed by other countries	3,843,680,000
		6,383,680,000

*Allows for authorized deferment of payments, as of September 27, 1946, by China, Czechoslovakia, Denmark, Greece, Norway, Poland, and Yugoslavia. These authorizations, permitted under the statutes for members suffering from enemy occupation or hostilities during the war, postpone payments of $5,165,000 in U. S. dollars for five years.

†For the purpose of meeting contractual charges on Bank obligations.

except that they allow for the addition of the four countries recently approved for membership, and enlarged subscriptions by France and Paraguay. They do not allow for the admission of any other new members or deferments of payments not authorized as of September 27.

Whenever necessary to cover its contractual obligations to holders of its debentures or bonds which it has guaranteed, the Bank can call upon its members up to a limit of $6,383,680,000 (the 80 per cent of capital not paid in for current operations) and calls under this provision would have to be met in gold, U. S. dollars, or those foreign currencies required to discharge the obligations of the Bank. The exact procedure for effectuating members' guarantees will presumably have to be established through some agreement upon interpretation of the rather brief provisions in the statutes.

With these resources, and proceeds from the sale of its own debenture bonds, the Bank has authority to lend or guarantee credits up to its $7,979,600,000 subscribed capital (plus reserves and surplus that may be built up). The subscribed capital may be increased, up to the $10 billion authorized, by participation of additional nations or further subscriptions by participants.

Some of the currencies held by the Bank, to be sure, will not be internationally usable. When losses arise and the need comes to call in more capital, the Bank more likely than not will find some countries unable to fulfill their obligations in gold or usable currencies. On the other hand, the amount which the United States and Canada may ultimately be required to pay in comes to $3,500,000,000. Beyond that, the British pound, with the help of the credit extended by this country, is working its way back toward wider international usability, and there are numerous other countries which, it is hoped, will have not only the desire but the resources to fulfill international obligations they have undertaken in the common good.

Bank Debenture Offerings

The Bank can make loans out of its own capital, but most of the funds it will make available to borrowers will be sought from private investors and institutions through its own debentures and bonds which it will guarantee. Thus the operations of the Bank will be subjected to the "test of the marketplace". The Bank expects to rely primarily upon the United States market, though offerings may also be made in some other markets where capital and products needed for reconstruction and development are available. The Bank is already considering loan applications, and is developing plans for the first offering of its own securities.

The salability of the Bank's obligations will be influenced by the character of loans the Bank makes, as well as by the kinds and terms of obligations it offers. Initial lending operations will be watched with keen interest, and evidence that the Bank intends to proceed cautiously, and not attempt too much, will go a long way towards increasing confidence in its securities.

Market sentiment suggests that debenture bonds probably will develop a receptive market more quickly than obligations guaranteed by the Bank. Present legal prohibitions on insurance company and savings bank investments will have to be lifted to give the Bank a wide market for its obligations. If initial offerings of Bank obligations are made before legislative action upon these restrictions, the International Bank presumably would have to rely to a considerable extent on commercial banks for a market.

The Question of Commercial Bank Participation

The question of goodness will be one for each investor to settle for himself. The American Bankers Association, after careful consideration, endorsed the Bank project at the Congressional hearings on the Bretton Woods legislation in the Spring of 1945. The Bank is not a relief organization. Its statutes provide that it is to make loans only after a competent committee has submitted a written report recommending the project after careful study of its merits, and with due regard to the prospects that the borrower will be in a position to meet its obligations. The Bank is to "act prudently". The United States has veto power over any loan to be financed by funds from this market. The Bank can make loans, moreover, only after it is assured that borrowing cannot be done through commercial channels under reasonable conditions. Thus the Bank is organized to deal with borderline cases which are expected to be good loans but which involve a little too much risk for private lending.

The question of how much a commercial bank might buy is affected also by legal limitations upon the amount of securities of any one obligor that may be purchased. State laws vary, but the Federal limit applicable to national banks and other member banks of the Federal Reserve System is ten per cent of capital and surplus. Legal exceptions to this limitation have been made for obligations of the United States and for general obligations of State or local governments, as well as for those of a number of government agencies. No proposal has yet been made, nor have the banks indicated any desire, for the lifting of this limit for obligations of the International Bank.

As for commercial banks acting as dealers in these obligations, their correspondent bank relationships and long experience with State and municipal bonds and obligations of such semi-government organizations as the Federal

Land Banks, Federal Intermediate Credit Banks, and Federal Home Loan Banks, have provided a mechanism for distribution that might be usable for broadening the market for obligations of the International Bank. For banks to act as dealers, however, would require some change in federal law, in which a number of banks have shown interest.

On the question of maturities, one consideration is that banks, generally speaking, favor a range up to about ten years. The Government recognized this in the war bond drives by making longer-term issues ineligible for bank purchase. In fact, the banks in the aggregate have the greater part of their investments coming due within five years in order to minimize risk of loss through price changes and to be ready to take care of customers' requirements.

The International Bank, of course, cannot rely too heavily upon borrowings for five or ten year terms. On many of its own loans, for reconstruction and development projects, considerably longer periods of time must be allowed for repayment, and the Bank's own financing ought to parallel at least approximately the repayment schedules on its own credits. In other words, the Bank should not "borrow short and lend long".

Clearly, therefore, a market will have to be developed, outside the commercial banks, for the longer-term obligations. The mainstays here are insurance companies and, to a lesser extent, savings banks and individuals. In New York State the Bank's obligations have recently been made eligible for investment by mutual savings banks and trust funds, though no action has yet been taken with respect to insurance companies. Numerous changes in the laws of the various States will have to be made to permit the development of an adequate market at the "long" end.

The International Monetary Fund Experiment

While the International Bank faces many difficult problems, it will have at least the advantage of using well-established lending techniques. Not so the International Monetary Fund, which will operate on quite different principles.

As originally proposed, the Fund plan was for an international clearing house or stabilization fund where financial settlements between nations could be carried out economically and simply by bookkeeping entries in terms of a new international currency. It was probably the outward reasonableness of this proposition, and — even more — recognition that a durable peace and prosperity would require friendly collaboration among nations and exchange stability that gained a hearing and eventual acceptance for the Fund proposal in the United States.

The plan for a new world currency was dropped in the later drafts of the proposal, but a novel provision for open drawing accounts was retained in the plan as put before the experts at Bretton Woods and accepted by them. What this means is that a country may, by deposits to the credit of the Fund on the books of its central bank, draw dollars or other scarce currencies out of the Fund. This was the plum in the Bretton Woods pudding, and the experts there vied with each other for bigger quotas (drawing rights) in the Fund and smaller contributions to the Bank.

The danger to the Fund in the open drawing account is that its supply of good currencies may be drained off in exchange for currencies not freely acceptable in international settlements. This peril is intensified by currency dislocations which the war left in its wake, worldwide inflation, the disordered state of government finances in so many countries, and expectations in some quarters that the Fund's resources would become available for relief and reconstruction. Unlike the Bank, the Fund will not be subjected to the test of the free market; there will be no way the public can record its reaction to the soundness of the credits extended.

Risks Recognized

It is therefore distinctly encouraging to find, in the first annual report of the Executive Directors of the Fund, submitted to its Board of Governors September 27, such frank recognition of "risks" and "dangers", so many words of good advice to member countries, and so many disclaimers of the idea — widely disseminated while the matter was before Congress — that the Fund itself was a prescription for almost every sort of currency difficulty. The following are significant passages:

> The road ahead is not an easy one. Although foreign aid has been of great assistance, it is important to recognize that recovery in the occupied countries has depended and will continue to depend primarily on their own efforts . . .
>
> No monetary organization, however ably devised, can be a substitute for wise policies in the national and international sphere . . .
>
> The primary sources of inflation or deflation are found in national policies. There is not a great deal that the Fund can do to eliminate the instability of domestic prices where the chief sources and price fluctuation are in domestic arrangements. But the Fund can help to minimize the effects of monetary instability by preventing it, to some extent, from spreading to other countries . . .
>
> It is clear that in starting operations at a time when much remains to be done in reconstructing the war-devastated economies, the Fund runs the risk that some of its resources may be used for other than temporary assistance . . .
>
> The Fund will clearly not serve as a relief agency like UNRRA: it cannot give foreign exchange away. Nor would it sell foreign exchange to a member when there is no reasonable prospect that the member will be able to repay the Fund.

This is all good sound sense. The question, however, is one of resisting political pressures; and there will be some tough problems to be faced in deciding how long is "temporary", and getting across some of the hard realities to improvident finance ministers who want to borrow more and more and who can cite chapter and verse to prove, at least to their own satisfaction, that they have the right under the statutes.

While the Fund has called for the par values of member currencies as of October 28, 1945, and offered to discuss "all matters related to the initial determination of par values", the actual fixing of exchange rates, except for the key countries, will presumably require months of careful study, and in many cases must await restoration of political and economic stability. The difficulties of attempting to fix exchange rates under present conditions are well described in the following statement from the Executive Directors' report:

> Many countries have only begun to recover from the devastation of war; and the reconstruction of their economic and monetary systems will take several years. The wartime economic controls of many members of the Fund are still in force. Inflation, in varying degrees of intensity, is in progress throughout much of the world. International trade and international investment are only partially restored. Concrete measures for international economic cooperation, in spheres other than the financial, are not as far advanced as had earlier been hoped. International political cooperation leaves much to be desired.

Meantime, the call for par values should put to rest the constantly recurring rumors of new tampering with the dollar or a revaluation of the pound. Secretary Snyder and Chancellor Dalton have reaffimed the present values of the two currencies which must serve as keystones for the stabilization of others.

Organizational Difficulties

Another problem faced by both the Bank and Fund, which was foreseen by many at the time of the Bretton Woods discussions, is that of finding qualified personnel for two institutions. Pointing out that "In most countries there is a shortage of the kinds of skilled financial and economic personnel that the Fund and other international organizations are seeking" the Fund's report states that "Because of this shortage, the treasuries, central and private banks and exchange departments of many countries are unable or reluctant to release their personnel. Of those who can be released, a considerable number are reluctant to give up established positions to undertake new work in another country."

This is by no means an inconsequential problem, for the chances of success will depend in large measure on the quality of the men who operate these institutions. In many countries the men with proper qualifications for top positions are few in number — sometimes only one or two.

Besides the Managing Director of the Fund, President of the Bank, department heads and staffs of the two institutions who are supposed to do the real work, the statutes, based on the present membership, provide for 170 jobs as Governors or Alternate Governors, each entitled to attend annual and other meetings at the expense of the Fund or Bank; and a minimum of 48 jobs as Executive Director or Alternate Executive Director, each entitled to full-time salary.

The question has been asked before, and will be asked again, as to why *two* institutions with parallel organizations from top to bottom are needed. The United States, in the Bretton Woods Agreements Act, set an example which a considerable number of other countries have followed, in providing that the positions of U. S. Governor of the Bank and U. S. Governor of the Fund should be held by the same person. A few countries have named the same man as Executive Director of both the Bank and Fund, but this is the exception.

All this lends force to the argument that eventually the two organizations ought to be combined, as was suggested in the Congressional hearings.

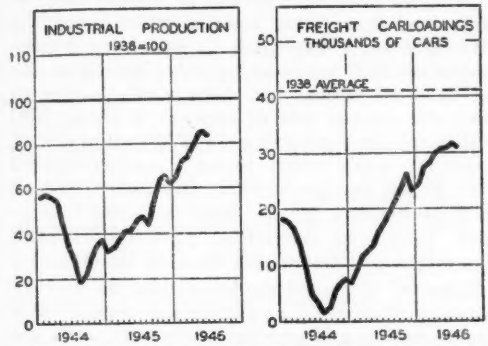
In the meantime a group of exceptionally able men from many countries has been assembled to consider together on international monetary and investment problems. This in itself is of great value.

Progress of French Recovery

Those who saw France two years ago at the time of liberation, or even one year ago when recovery was temporarily checked by a severe drought, are impressed by the progress of reconstruction. Despite confusion in government policies and political strife, it is apparent that individual French men and women have buckled down and in their own way are coping with their problems. Stores have more and a greater variety of goods on their shelves, and there has been a good seasonal abundance of farm products. More hotels and restaurants are opening, and resorts are getting ready for increasing tourist trade. Although the railway rolling stock is far from adequate, all the French railway lines have been in operation for some time, and many of the famous international through-trains have been reinstated. While many types of goods and services are still scanty or unavailable, and inflation continues painful, nevertheless France since the liberation has come a long way.

The extent of economic revival is reflected in production and trade figures. Industrial output is better than 80 per cent of the 1938 level, compared with approximately 45 per cent in the summer of 1945, and 20 per cent at the time of the liberation. In some industries —

glass, rubber, chemicals, and textiles — production has actually topped prewar; in certain textile and chemical lines, it is reported to have nearly doubled. Motor trucks are being turned out at a rate about twice that of prewar. This year the crops are generally the best since 1939, though still below the prewar average.



Industrial Production and Railway Freight Loadings.

The improvement in economic conditions is the more striking in view of the intense political antagonisms that have divided the French people. This turmoil reflects the far-reaching political, social, and economic changes taking place, and inability of either Left or Right to obtain a decisive political majority. The strengthening of the more moderate parties in the May elections, however, has been evidence of a preference for orderly and constitutional over revolutionary methods.

One of the most serious handicaps to recovery has been uncertainty as to how far nationalization of industry would be carried. Recognizing this, former President-Premier Gouin, in an address to the Constituent Assembly last January, undertook to define the Government's intentions as to nationalization and to urge prompt action, as follows:

> To this end (recovery), the Government this very day is defining with precision the fields in which it intends to apply its nationalization program and those that will remain in the domain of free enterprise which can and should be the field for private investments.
>
> In the domain of public enterprise, to put an end to the uncertainties checking the resumption of business, the maximum speed will be undertaken in voting the bill on electricity and gas, the nationalization of certain big investment banks, of certain insurance companies and mining companies, the partial nationalization of the merchant marine, of river transport, of freightage via inland navigation and the transformation of former national corporations into the new forms.

A large share of this program has been carried out. Since the liberation, nationalization of the coal mining industry, the Bank of France and four leading commercial banks, the electric power and gas industries, and the principal French insurance companies has been completed. In addition, the Government operates, but has not formally nationalized, two automobile and two aircraft companies.

It should, of course, be borne in mind that public ownership is by no means a new feature of the French economy. Before the war France had publicly owned the railroads, the post office, telephone and telegraph companies, tobacco and match production and some coal mines, and the Government exercised close control in numerous other lines, including munitions and air transport.

It has been reported that French public sentiment for nationalization has recently abated. Whether the movement has yet run its course remains to be seen and will depend very much upon the complexion of the new Legislative Assembly to be elected this month. If the new Assembly is on the pattern of the present one, it is highly probable that no further nationalization is imminent.

Coal and Labor Bottlenecks

For France's economic regeneration, the continuing task is to increase production. Without an increase in the supply of goods that people can buy, no program for checking the rise of prices and cost of living that unquestionably accounts for much of the political radicalism can hope to be successful.

Here, however, France faces two particularly serious bottlenecks—coal and manpower shortages. The coal shortage has hit especially the heavy industries, now operating in some cases at little more than half capacity.

So far as France's own coal output is concerned, the record is good. Monthly production is now exceeding the prewar rate, making France the first European country to attain that distinction. Unfortunately, the coal bottleneck cannot be solved by France alone, but — because of France's dependence upon coal imports — is an all-European problem. While French coal imports are rising, August figures were still one-third below the 1938 average, and much of this recovery reflects increased imports of American coal, which is relatively costly. Total coal supplies must not only reach, but substantially exceed, the 1938 level — not an especially good year for French industry generally — if reconstruction needs are to be met.

More serious than the coal shortage is the over-all manpower shortage, affecting industry and agriculture both. Not only did the native French population decline during the war, but the labor force was depleted by exodus of large numbers of foreign workers. As a result, there has been some doubt expressed that the labor force is large enough to attain even the 1938 production level, let alone do better. As one way of meeting this problem, the Government within the past month has announced its intention of offering permanent residence to the 700,000 German prisoners now working in the country, and of establishing a ten-year immi-

gration program aimed at getting 3,000,000 new citizens.

A more basic solution, however, is recognized to be that of increasing the productivity of the French workman and farmer. Because of antiquated methods, lack of mechanization, and the small size of manufacturing establishments, the productivity of labor in France has been far below American and British standards. According to data compiled by the French Ministry of National Economy, the American industrial worker produces three to four times more than the French, while in agriculture the American farmer feeds 15 persons on the average and the French only 5.

French Modernization Plans

It is the aim of the four-year program of industrial and agricultural modernization (known as the Monnet plan, from one of its principal originators, M. Jean Monnet, now head of the Council for Modernization and Re-equipment) to overcome these production deficiencies, and "to raise the yield of labor to the level of countries where it is the highest."

Under this program, adopted early this year, modernization of out-dated plants and equipment is to have precedence even over reconstruction in the strict sense, and is to be directed particularly to five basic industries — steel, transport, coal, cement, and electricity. Agriculture is to be further mechanized (the program calls for delivery of 50,000 tractors a year for four years), and modernized as to soil utilization and processing of farm products, with arrangements for cooperative pooling of farm implements and manpower.

A feature of the French program is the careful advance planning and consultation by the Government with representatives of industry, labor, and agriculture. On this point, the comments by the New York Times correspondent, Michael L. Hoffman, in a Paris despatch of October 15 are interesting:

> Unlike the Russian type of planning, the French plan is built from the bottom up. More than 1,000 individuals from trade unions, industrial managements, and government departments, including scientists, work in groups for months, going over industries with which they are familiar. At every step all varieties of opinion have been brought to bear on technical as well as policy problems.

Total annual cost of modernization (including repairs and replacements) is calculated to exceed $4 billion at 1938 prices, an amount equivalent roughly to a third of the total national production in that year.

Imports and Balance of Payments

In carrying out these plans, France will have to buy heavily abroad, including large amounts of industrial and transportation equipment from the United States

It is clear that, at least in the initial stages, France will be unable to pay for these imports and still balance her current international accounts. With the great need for raw material restocking and equipment purchases, it is not surprising that imports have been running way ahead of exports. While the Government is striving to build up exports as rapidly as possible, and has been making more progress than had been expected, it has been handicapped by high prices and goods shortages. On the basis of figures for the second quarter of 1946, the annual rate of exports is about $880 million, about the same as in 1938 (when prices, however, were much lower), and compared with $1,966 million in 1929. Moreover, not all of these exports are to "hard currency" countries where an important part of France's equipment purchases will have to be made.

Some of the need doubtless can be met by drawing upon gold and external assets, both governmental and private. However, with the gold reserve of the Bank of France already reduced from the equivalent of about $2.7 billion before the war to less than $800 million, there is a question as to how much further it can be drawn down at a time when the Government is anxious to restore confidence in the franc. Private assets (gold, bank balances, and securities in sound currencies) have been estimated officially at about $1 billion on the basis of incomplete figures, though much higher unofficial estimates have been published.

Pending, therefore, the further recovery of exports and of tourist trade income, there will be need for France to borrow abroad. From the time of liberation to date, French external borrowings (including reciprocal exchange credits) have totalled around $2.8 billion, of which some $1.9 billion has been from the United States. In addition, France within the past month has applied for a loan of $500 million from the new International Bank.

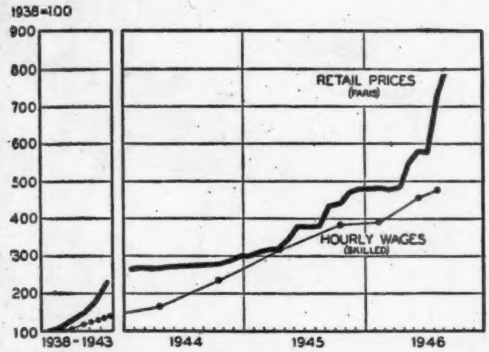
The Inflation Problem

Contrasting with the progress of production has been the delay in coming to grips with the inflation problem. The continuing large budgetary deficits, together with failure to deal adequately with the huge money supplies created by the war, go far to explain why France, though the most favorably situated from the standpoint of natural resources, has been perhaps the least successful of the western European countries in controlling inflation.

During the current fiscal year ending December 31 ordinary expenditures, together with costs incurred in "liquidation of war", are expected to reach Fr. 500 billion, against receipts of Fr. 380 billion, leaving a deficit of Fr. 120 billion. To this deficit, however, must be added Fr. 212 billion for reconstruction and re-equipment and Fr. 48 billion for Treasury

advances to cover railway and air lines deficits, making a total Treasury deficit of Fr. 380 billion. Since about one-third of this figure, however, represents expenditures for materials and equipment from abroad financed by foreign loans or liquidation of foreign assets, it is to that extent anti-inflationary in its effect upon the French economy.

The accompanying chart on the movement of French prices and wages since 1938 indicates the extent of the inflationary advance.



Indexes of Wages and Retail Food Prices in France. 1938 = 100.

It will be seen that the index of retail prices of 29 rationed food articles in Paris, which at the time of the liberation stood at approximately 2¾ times prewar, had reached by the middle of this year a level nearly 6 times prewar. From July to September the index jumped from 576 (1938=100) to 785, due partly, however, to an adjustment to reflect certain prices already prevailing in the black market. Last December the franc was officially devalued from 49.53 to 118.90 to the dollar.

Wage rates, as measured by the index of hourly earnings of skilled workers, had advanced by August 1946 to a level some 4¾ times prewar. Only last summer the Government was forced to authorize general wage increases of 18 to 25 per cent, the third general wage increase since the liberation. Even so, the advance in wages has failed to keep pace with prices, and labor leaders have served notice that further wage increases will be required if the price rise is not halted.

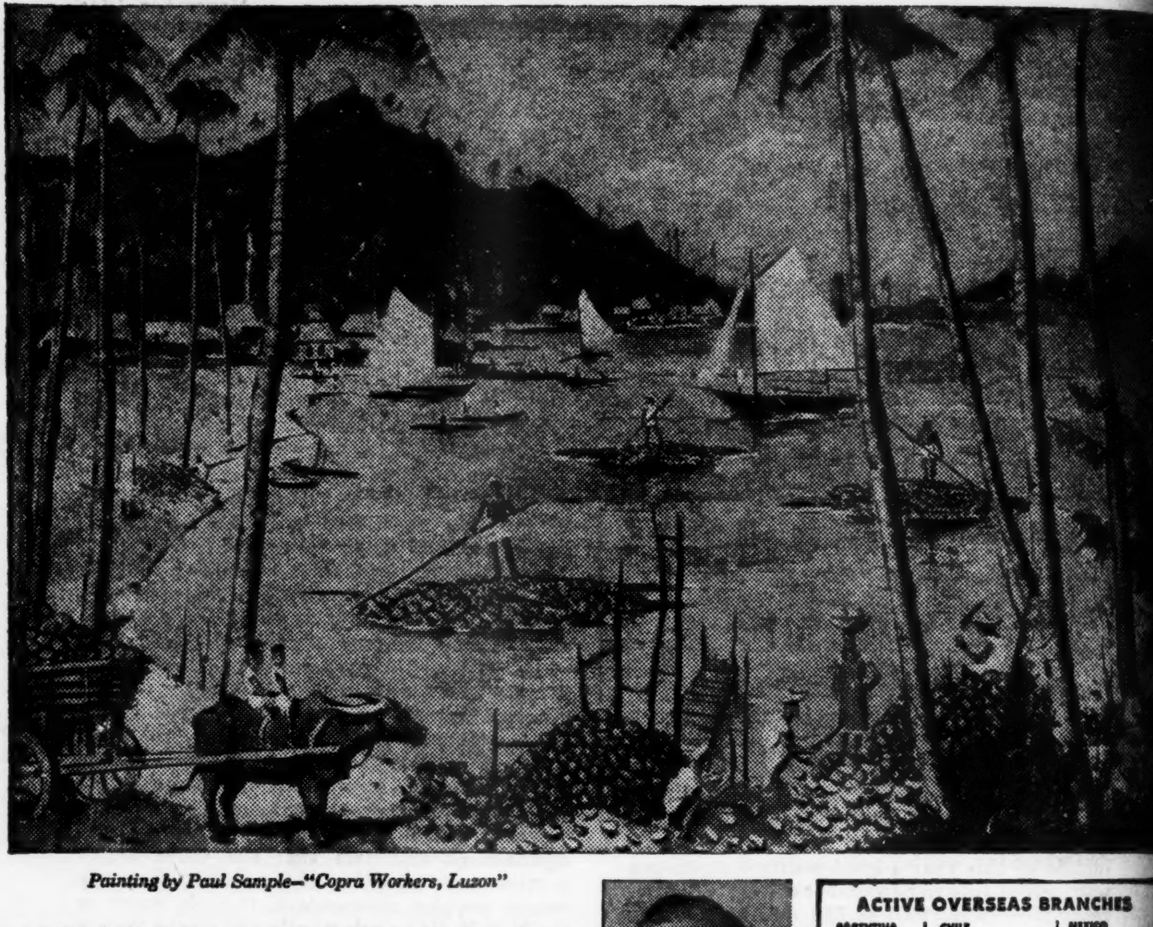
Need for Political Stability

While the French Government has been aware of the need for stronger measures to improve the budgetary position and curb inflation of wages and prices, it has been handicapped by its own provisional nature and divided party support. With the uncertainty that has prevailed as to French political destinies, and with the three dominant political parties — the Communists, the Socialists, and the more moderate M.R.P. (Mouvement Republicain Populaire)—sharing almost equally in the Government, the situation has been far from conducive to strong and effective action.

As a result, public confidence in the Government's ability to control inflation has suffered. With people anticipating a fall in the value of their money, the tendency has been to hoard goods and not sell, thus accentuating scarcities and helping to drive prices still higher. In France, as everywhere else, price controls have failed to stop the upward march of prices where the underlying inflationary forces are still operating. In the opinion of many, a strong government in which the people would have faith would have a salutary psychological effect in checking inflation by stopping hoarding and creating an inducement to sell, — would in fact be a necessary basis for carrying out an anti-inflationary monetary program.

In view of the progress being made in production, and the natural resources and habits of industry of the French people, the problem in a nutshell has been how soon they could get a permanent government with the necessary support from the public to take the steps required to solve the financial difficulties. The adoption of a new constitution providing framework for a permanent government is an essential step in that program. It was in recognition of this fact that the three major parties urged adoption of the new draft at the recent popular referendum, though many in the M.R.P. did so reluctantly and on the theory that the features to which they objected (excessive balance of power in the Assembly) could be corrected by amendment, and that to accept the instrument in its present form was better than to reject it and have to start all over again.

While the Constitution was adopted at the polls, the narrow margin of approval, the active opposition of General de Gaulle, and the large percentage of people who abstained from voting, have left the political situation still unclarified. This much, however, can be said, — the country has a constitution, which is all to the good, yet by a closeness of vote which strongly controverts any claim that the people are satisfied with the new charter and do not want it amended. If the elections on November 10 should bring about a stable governmental coalition which will inspire confidence and give courage to enterprise, the economic recovery already so well under way should go forward with renewed vigor.



Painting by Paul Sample—"Copra Workers, Luzon"

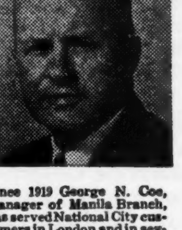
Dollars for Coconuts, in the Philippines

PHILIPPINE COPRA—dried coconut meat—is the source of coconut oil, one of the world's most versatile commodities. Its principal use is in soap-making and the by-product, glycerine.

Before the war, the Philippines were the world's largest exporters of coconut products. The coconut industry has been one of the first to recover after the liberation. Other export products beginning to move in quantity include Manila hemp, manganese and chrome ore. It will take some time to restore the flow of exports such as sugar, gold, tobacco, hats, pearl buttons, cabinet woods, and embroidery.

Foreign trade of the Philippines increased about fivefold during the forty years of American sovereignty. By the end of the year our exports to the Philippines are expected to reach substantially higher levels.

The only American Bank in the Philippines, the Manila Branch of the National City Bank is a complete and long-established unit which exporters and importers use to build foreign trade and business men generally utilize for all types of financial transactions in the Islands.



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